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C O N F I D E N T I A L MEXICO 8939

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TAGS: ENRG, MX, CU, EFIN

SUBJECT: SOME POSSIBLE ECONOMIC IMPLICATIONS OF
MEXICO'S RECENT OIL DISCOVERIES.

PASS TREASURY FOR INFORMATION

SUMMARY

1. ECONOMIC BENEFITS OF RECENTLY DISCOVERED OIL WILL NOT, EVEN IF FULLY EXPLOITED, BECOME APPARENT UNTIL 1976 OR LATER. UNTIL THEN, MEXICO WILL HAVE LARGE EXTERNAL FINANCING REQUIREMENTS. SHOULD MEXICO BE RELUCTANT TO EXPLOIT ITS OIL DISCOVERIES AS RAPIDLY AS POSSIBLE, PRESSURE COULD BE BROUGHT TO BEAR ON GOM THROUGH ITS FOREIGN CREDITORS SUCH AS WORLD BANK, IDB AND EXIMBANK. USG, IN ITS BILATERAL RELATIONS, MAY WISH TO PRESS FOR REDUCTION OF MEXICO'S MANY NON-TARIFF BARRIERS WHICH EXIST FOR BALANCE OF PAYMENTS PURPOSES AS WELL AS TO PROTECT LOCAL INDUSTRY. MEXICO WILL PROBABLY RESIST ATTEMPTS TO MAKE IT AN AID DONOR AND USE ITS INCREASED RESOURCES TO MAXIMIZE ITS OWN ECONOMIC GROWTH. END SUMMARY

2. MEXICO HAS YET TO MAKE A DECISION AS TO WHAT DEGREE IT SHOULD EXPLOIT ITS NEW OIL DISCOVERIES. NOR DOES IT KNOW THE VOLUME OF ITS NEWLY-LOCATED OIL. THERE IS A STRONG ELEMENT THAT WISHES TO CONSERVE OIL RESERVES FOR FUTURE GENERATIONS AND PRODUCE ONLY WHAT IS NEEDED TO
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MEET NATIONAL REQUIREMENTS.

3. SHOULD MEXICO OPT NOT TO PRODUCE OIL IN EXCESS OF ITS NATIONAL NEEDS, SOME PRESSURE COULD BE PUT ON THE MEXICANS TO PRODUCE MORE BY REDUCING ITS ACCESS TO WORLD BANK, INTER-AMERICAN BANK AND EXIMBANK FUNDS. THIS WOULD BE LOGICAL SINCE THESE BANKS HAVE A LONG LIST OF POTENTIAL BORROWERS WHOSE NEEDS ARE GREATER THAN MEXICO BECAUSE OF A LACK OF NATURAL RESOURCES.

4. FROM AN ECONOMIC POINT OF VIEW, MEXICAN POLICY SHOULD BE TO PRODUCE ENOUGH OIL TO PERMIT EXPORTS IN AN AMOUNT ADEQUATE TO COVER ITS CURRENT ACCOUNT DEFICIT THEREBY ELIMINATING ITS NET NEW EXTERNAL FINANCING REQUIREMENTS. MEXICO'S CURRENT ACCOUNT DEFICIT IN 1974 WILL BE AROUND \$2 BILLION. TO FINANCE THIS, IT WOULD HAVE HAD TO EXPORT AT \$10 PER BARREL, ABOUT 200 MILLION BARRELS ANNUALLY, OR, BASED ON A 365 DAY-YEAR, 548 THOUSAND BARRELS DAILY. IT WILL BE SEVERAL YEARS BEFORE THIS LEVEL COULD BE REACHED.

5. SHOULD OIL EXPORTS EXCEED THE AMOUNT NECESSARY TO COVER ITS CURRENT ACCOUNT DEFICIT AND AMORTIZATION OF EXTERNAL DEBT, MEXICO WOULD PROBABLY WANT TO INCREASE ITS OFFICIAL RESERVES SOMEWHAT. IT WOULD PROBABLY BE RELUCTANT TO ENGAGE IN ANY CONCESSIONARY LENDING. THE FIRST CLAIMANT WOULD PROBABLY BE THE IDB'S FUND FOR SPECIAL OPERATIONS. MEXICO HAS A REPUTATION FOR HARD BARGAINING IN THE INTERNATIONAL CAPITAL MARKETS AND WILL LIKELY HAVE TO BE DRAGGED INTO ANY CONCESSIONARY LENDING.

6. SHOULD MEXICO OPT FOR A HIGH GROWTH STRATEGY USING ITS NEW RESOURCES, IT IS LIKELY TO CONTINUE TO TIE THE PESO TO THE DOLLAR AND MANAGE ITS GROWTH POLICIES IN SUCH A WAY AS TO MAINTAIN RELATIVE PRICE STABILITY VIS-A-VIS THE U.S. WHILE PETROLEUM AND DERIVATIVE INDUSTRIES, PARTICULARLY FERTILIZERS, WOULD UNDOUBTEDLY RECEIVE PRIORITY IN THE CALL ON NATIONAL RESOURCES, MEXICO WOULD WANT TO STRIVE FOR HIGHER GROWTH RATES IN AGRICULTURE AND MANUFACTURING AS WELL AS OTHER NON-PETROLEUM SECTORS OF THE ECONOMY. THIS WOULD REFLECT THE NEED TO PROVIDE JOBS FOR MEXICO'S
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GROWING POPULATION AND ITS UN-AND UNDER-EMPLOYED AND THE DESIRE TO DEVELOP A WELL-BALANCED ECONOMY IN ORDER TO AVOID FUTURE DEPENDENCE ON OIL.

7. MEXICO'S GROWTH STRATEGY WOULD RESULT IN A CONTINUED LARGE OR EVEN LARGER TRADE DEFICIT, EXCLUDING OIL EXPORTS. IMPORTS WOULD CONTINUE TO BE CONCENTRATED IN CAPITAL GOODS, RAW MATERIALS AND, TO THE DEGREE NECESSARY,

BASIC FOODSTUFFS. IT WOULD PROBABLY RESIST INCREASES IN IMPORTS OF CONSUMER ITEMS OTHER THAN FOODSTUFFS, EVEN IF SUCH IMPORTS WOULD DAMPEN INFLATIONARY PRESSURES. THUS, TO A LARGE DEGREE, MEXICO'S IMPORTS WOULD BE CONSTRAINED BY THE ECONOMY'S ABILITY TO ABSORB NEW INVESTMENT WITHOUT EXCESSIVE PRESSURE ON PRICES. WHILE IMPOSSIBLE TO QUANTIFY AT THIS POINT, WE WOULD IMAGINE THAT IT WOULD BE AT LEAST 4 TO 5 YEARS BEFORE MEXICO WOULD BE READY TO BECOME A NET CAPITAL EXPORTER IN ANY SIGNIFICANT SIZE AND IT WOULD VERY LIKELY REDUCE PRODUCTION RATHER THAN BECOME ONE. MEXICO WILL, IN OUR ESTIMATION, USE ITS RESOURCES TO MAXIMIZE ITS ECONOMIC GROWTH RATE THROUGH A HIGH LEVEL OF IMPORTS RATHER THAN BECOME AN AID DONOR.

8. STEPS FOR USG CONSIDERATION: (A) THE USG COULD ENCOURAGE THE GOM TO CEASE BORROWING FROM THE WORLD BANK AND IDB; IT COULD ENCOURAGE THE GOM TO MAKE A CONVERTIBLE CURRENCY CONTRIBUTION TO THE IDB'S FSO. IT COULD ALSO ENCOURAGE THE GOM TO PREPAY SOME OF ITS OUTSTANDING LOANS FROM THESE INSTITUTIONS, AND THE EXPORT-IMPORT BANK. SUCH A POLICY COULD BE AN ALTERNATIVE TO GOM CONCESSIONARY LENDING; (B) THE USG COULD ENCOURAGE THE GOM TO DISMANTLE SOME OF ITS NON-TARIFF BARRIERS. THESE ARE THE RESULT OF MEXICO'S DESIRE TO PROTECT LOCAL INDUSTRY AND ALSO TO CONTROL THE BALANCE OF PAYMENTS. MEXICO HAS VIRTUALLY NO CONTROLS OF INVISIBLES BECAUSE OF THE IMPOSSIBILITY OF ENFORCING SUCH CONTROLS. ITS CONTROLS ON TRADE ACCOUNT ARE TO SOME DEGREE AN ALTERNATIVE TO CONTROLS ON INVISIBLES. THE NTRS ARE A TOOL TO ENABLE MEXICO TO MAINTAIN THE 12.5 EXCHANGE RATE AS THEY REDUCE IMPORT DEMAND (AND DIVERT SOME OF IT TO SMUGGLED GOODS) AND STIMULATE DOMESTIC PRODUCTION. WITH ITS OIL RESERVES, MEXICO COULD DROP THESE NTB'S AND RESORT TO

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TARIFFS FOR PROTECTION PURPOSES, IDEALLY AT A LOW LEVEL. THIS COULD HELP REDUCE PRICES OR THEIR RATE OF INCREASE IN MEXICO BY FORCING LOCAL PRODUCERS TO BE MORE EFFICIENT AND COMPETITIVE. IT WOULD BE OF FUTURE BENEFIT TO MEXICAN EXPORTS

9. FURTHER INFORMATION IS NEEDED BEFORE THE VOLUME OF MEXICO'S OIL RESERVES WHICH CAN BE EXPLOITED IS KNOWN. MEXICO'S ECONOMIC SITUATION AS OUTLINED IN THE ECONOMIC TRENDS REPORT BEING POUCHED TO WASHINGTON(SLOWER GROWTH RATE, CONTINUED INFLATION, HEAVY DEPENDENCE ON EXTERNAL FINANCING) WILL PROBABLY REMAIN VALID UNTIL 1976. THE TRANSITION TO A CURRENT ACCOUNT BALANCE OR SURPLUS SHOULD NOT OCCUR OTHER THINGS BEING EQUAL, UNTIL LATE 1976 OR 1977. IN THE MEANTIME, MEXICO WILL BE IN THE

MARKET FOR FINANCING. IT WHOULD BE ABLE TO OBTAIN ADEQUATE FUNDS FROM PRIVATE SOURCES, BUT MAY ENCOUNTER AN INCREASING RELUCTANCE ON THE PART OF THE WORLD BANK AND IDB TO LEND IN LARGE AMOUNTS TO MEXICO. THE USG MAY SUPPORT SUCH A POLICY ON THE GROUNDS THAT THE PROSPECT FOR LARGE OIL EXPORTS WILL ENABLE IT TO RAISE FUNDS EASILY ON CAPITAL MARKETS AND THEREFORE IT SHOULD PERMIT THE IDB AND IBRD TO LEND THEIR LIMITED RESOURCES TO MORE NEEDY BORROWERS. THIS WOULD CAUSE THE MEXICANS SOME CONSTERNATION, BUT THEY SHOULD BE ABLE TO LIVE WITH IT.

JOVA

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